Journal of Asian Economics 39 (2015) 108–125

Contents lists available at ScienceDirect

Journal of Asian Economics

Constraints to the growth of small firms in Northwest Myanmar

El-hadj M. Bah *, Geoff Cooper [1]

Department of Economics, The University of Auckland, Auckland, New Zealand

ARTICLE INFO

Article history:
Received 30 September 2014
Received in revised form 9 June 2015
Accepted 18 June 2015
Available online 25 June 2015

Keywords:
Rural investment climate
Enterprise development
Poverty reduction
Small firms growth
Myanmar

JEL classification:
O1
O5
L2

ABSTRACT

This paper uses survey data collected from Northwestern Myanmar to analyze business activity and determine the most binding constraints to firm growth. Most households in the region are operating informal firms with low earnings and no employees. The most binding constraints are related to external financing and competition. Firms that view access to informal credit as a major constraint are 9.6% less likely to invest and grow, on average, 5.7% less in 2008–2010. Restricted access to markets is also a major binding constraint, reducing the likelihood of investment up to 15.3% and income growth up to 6%.

1. Introduction

At the dawn of the 20th century, Burma was the richest state in Southeast Asia, glimmering with prosperity and the expectation of greater things. By the dawn of the 21st century Myanmar was the poorest state in Southeast Asia (Turnell, 2009). Its grand buildings were in decay, its borders were shut and its people were among the poorest of any in the world. As Turnell (2009) comments "[Myanmar's history] is a history of repression and release, and repression again. It is a history of economic construction, reconstruction and decay. It is a history of plans, and of chaos. It is a history of hope, and hopes dashed".

After independence from Great Britain in 1948, the country experienced political instability and armed conflicts. The military took power in 1962 and instituted the "Burmese Way to Socialism" which led to the nationalization of all major industries, the rejection of democracy, and increased military dominance. The socialist policies led to an economic decline that resulted in the country reaching the status of a least developed country in 1987. Widespread protests in 1988 and the brutal crackdown on August 8, 1988 pushed the military to embark on market reforms. Accompanying

* Corresponding author. Present address: African Development Bank, Development Research Department, Avenue Jean Paul II, Abidjan, Cote d'Ivoire. Tel.: +225 20264428.
E-mail addresses: e.bah@afdb.org (E.M. Bah), gccooper@princeton.edu (G. Cooper).
[1] Present Address: MPA Candidate, Woodrow Wilson School of Public and International Affairs, Princeton University, United States.

http://dx.doi.org/10.1016/j.asieco.2015.06.002
1049-0078/

political reforms started but were not completed as the military refused to give up power after the victory of the National League for Democracy (NLD) during the multi-party general elections in 1990. This act and continued violations of human rights prompted most western countries to apply economic and political sanctions to the country. Economically isolated and experiencing many armed conflicts, the market reforms started in 1990 did not lead to prosperity. However, with new reforms started in 2011, there is renewed hope for economic prosperity given its geographic and resource advantages.

The elements that underpin Myanmar's history of torrid economic development are not widely understood. This paper offers a rare glimpse into Kalaymyo, a city in the northwestern region of Myanmar, shedding light on the area's stagnant economic growth and the most important constraints to business growth. The research uses an original dataset of 677 households (including 494 firm owners) living in Kalaymyo in 2011. The survey was designed to provide information on the household, business and living conditions of individuals in Kalaymyo. The survey is broadly consistent with the World Bank Rural Investment Climate Surveys, so that firm constraints are comparable with global findings.

The relationship between poverty alleviation and business development is well established. As such, Kelly, Werhane, and Hartman (2008) argue that there are many feasible approaches to poverty reduction that are made possible through commerce; and further, that there are profits in developing markets of great consequence to poverty alleviation efforts, that have been previously overlooked. Accordingly, business conditions are important for poverty alleviation. Of particular interest then are constraints to the growth of businesses. Efforts to understand the constraints to enterprise growth in developing countries are not new. Staley and Morse (1965) comment ''By and large [enterprises of the poor] do not prosper. When they do prosper, it is not for long. [These] small industrial firms have never grown beyond a certain point, as if there were a physical barrier between the small and medium sized range impossible to cross''.

This physical barrier between small enterprises and medium enterprises has been a focal point of recent literature. Several papers use inter-regional datasets to evaluate differences that emerge across the world (Ayyagari, Demirguc-Kunt, & Maksimovic, 2008; Batra, Kaufmann, & Stone, 2004). Specifically, these papers evaluate a range of firm level constraints including national policy instability, financial constraints, regulation, inflation, exchange rate fluctuations and corruption. In each of these papers, the authors conclude that finance, corruption and property rights are important factors for firm growth in the developing world.

Another set of papers evaluates firm level constraints at a national level. Fisman and Svensson (2007) show that in Uganda, corruption is an important constraint to firm growth, with a one percentage point increase in the rate of bribery resulting in a three percentage points decline in firm growth. Using data from China, Bangladesh and India, Dollar, Hallward-driemeier, and Mengistae (2005) find that the availability of financial services has a strong positive effect on growth rates of assets, employment, and output. They also show that this effect varies within countries, indicating the importance of local governance. Bigsten and Soderbom (2006) conclude that investment in Africa is low because firms have been unable to identify investment opportunities. Credit constraints were therefore found to be an important, but not the most important constraint. Rajan and Zingales (1998) focus on the role of the financial sector, showing that countries with a more developed financial sector are better able to support the growth of firms.

The analysis of firm constraints in this study follows Dinh, Marvidis, and Nguyen (2010) and Hausmann, Rodrik, and Velasco (2008) in which the growth diagnostic approach is used to understand the most binding constraints on firm growth. This approach differs from previous efforts at understanding firm constraints in that it acknowledges that the list of constraints on enterprise growth in developing countries is a long one; and further, that due to scarce resources, it is impractical to address each of these constraints simultaneously. This approach therefore attempts to reveal the most ''binding'' constraints, defined as those having the largest effect on enterprise growth.

The results show that informal access to credit and restricted access to market were the most binding constraints for firm investment and income growth. Firms that identified informal finance as a major constraint to business growth were 9.6% less likely to invest and grew, on average, 5.7% less than other firms between 2008 and 2010. Restricted access to markets is also a major binding constraint, reducing the likelihood of investment up to 15.3% and income growth up to 6%.

The prominence of access to informal financing has to be put in the context of the financial history of the country, which resulted in a lack of trust in formal institutions. From independence, the country experienced three episodes of currency crises: 1964, 1985, and 1987. In an effort to curb very high rates of inflation in 1987, the government declared some currency notes invalid but failed to exchange the holdings of consumers with new currency notes. This pushed households to resort to barter and hoarding of goods. Rice became a store of value and exchange. The 1987 crisis resulted in the 1988 uprising, the subsequent internal military coup and the start of market reforms. However, the country experienced a severe banking crisis in 2003. There were bank runs, limits on bank withdrawals and transfers, and the cessation of other methods of payments (credit and debit cards, checks, remittance facilities, etc.). Instead of acting as a lender of last resort for the banks, the Central Bank of Myanmar (CBM) encouraged the recall of loans from private banks. This led to huge disruptions of the economy and a crash of the real sector (Economist, 2003; Turnell, 2003).

The rest of the paper proceeds as follows. Section 2 discusses the survey and data. Section 3 characterizes the firms and their owners. Section 4 analyzes the determinants of income, borrowing and investment. Section 5 evaluates the constraints to enterprise growth, establishing which ones are ''binding'' and Section 6 concludes.